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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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MEMORANDUM FOR DOUG ROGERS, DIRECTOR (PENALTY AND INTEREST
ADMINISTRATION) S:C:CP:RC:P

FROM: Assistant Chief Counsel (Administrative Provisions and Judicial
Practice)
CC:PA:APJP

SUBJECT: Managerial Approval for Penalty Assessments

This memorandum is in response to your request for advice dated November 29, 2000. You have raised several issues regarding I.R.C. § 6751(b), which requires that penalty assessments be approved in writing by a supervisor.

As originally enacted, the requirement of supervisory approval prior to assessment would have applied to all penalties assessed after December 31, 2000. See Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3306, 112 Stat. 685 (1998). However, the effective date of § 3306 of RRA 98 was extended until June 30, 2001. See section 302 of the Community Renewal Tax Relief Act of 2000 (H.R. 5662, incorporated in H.R. 4577, the Consolidated Appropriations Act, 2001), Pub. L. No. 106-554, § 302, 114 Stat. 2763 (2000).

Issues

1. Whether the Service is required to provide a taxpayer with a copy of the supervisor's written approval of a penalty assessment.
2. Whether a Revenue Agent Report (RAR) that includes penalties can be presented to a taxpayer for signature before the supervisor has approved the penalties.
3. Are there any penalties that fall within the exception of section 6751(b), besides those under sections 6651, 6654, and 6655, that are not required to have supervisory approval because the penalty is calculated through electronic means?

Conclusions

1. Section 6751(b) does not require that the Service provide a taxpayer with a copy of the supervisor's written approval of penalties assessed against the taxpayer. However, the Service may wish to provide the taxpayer with a courtesy copy of

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the document showing that a supervisor approved the penalties, and taxpayers may be entitled to request these documents under the Freedom of Information Act.

2. An RAR that includes penalties may be approved by a supervisor in writing after the RAR is presented to a taxpayer for signature. There is no requirement that the supervisor approve the penalty prior to sign-off by the taxpayer. However, we emphasize that all penalties (except those calculated through electronic means) must receive a meaningful review by a supervisor prior to assessment.
3. To fall within the exception of section 6751(b), the penalty must be calculated through electronic means. This means that the penalty must be free of any independent determination by a Service employee as to whether or not the penalty should be imposed against a taxpayer. The penalties referenced in your request for advice are not calculated through electronic means.

Analysis

Section 6751(b)(1) of the Code provides, in general, that no penalty under the Internal Revenue Code shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

Issue 1

Neither section 6751(b) nor the accompanying legislative history state that a taxpayer is entitled to receive a copy of the document showing that a supervisor approved the penalties assessed against the taxpayer. However, the Service may make a business decision to provide taxpayers with a courtesy copy of the document showing that a supervisor approved the penalties. Also, we note that taxpayers may be entitled to these documents under the Freedom of Information Act.

Issue 2

Section 6751(b)(1) requires the immediate supervisor to approve the "initial determination" of the penalty. The RAR may constitute the initial determination of a penalty. Therefore, an RAR with penalties falls within the requirements of section 6751(b)(1). We conclude that such an RAR must be approved by a supervisor in writing before any penalties included in the RAR are assessed against the taxpayer. As long as the supervisor performs a meaningful review of the penalty determination prior to assessment, there is no requirement of supervisory approval before the taxpayer agrees to the RAR.

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The legislative history states "the committee believes that penalties should only be imposed where appropriate and not as a bargaining chip." See S. Rep. No. 105-174, at 65 (1998). It is our understanding that when an agent submits an RAR with penalties to a taxpayer at the end of the audit the penalties could be used as a bargaining chip. For an example, an agent might propose or overstate an accuracy-related penalty with the expectation that the penalty will be reduced or removed if the taxpayer agrees to the tax adjustments. We would assume that this would occur only rarely. Nevertheless, this type of improper bargaining is what Congress probably had in mind when it enacted section 6751(b). We note that unsophisticated taxpayers and taxpayers who are not represented by a tax professional may be especially vulnerable to such bargaining.

We conclude that an RAR with penalties does not have to be reviewed by a supervisor prior to discussions with the taxpayer regarding the penalties. Nor does the RAR have to be reviewed before the taxpayer agrees to the penalties. However, we emphasize that the supervisor must perform a meaningful review of the agent's penalty determination prior to assessment. The supervisor should verify that the penalties were imposed fairly and accurately computed; that the agent did not improperly assert the penalties in the first instance as a bargaining chip; and that an agent's conclusions regarding "reasonable cause" (or the lack thereof) were proper. Documentation regarding the review of the penalties should be retained in the file.

Issue 3

Section 6751(b)(2) provides that a supervisor does not have to personally approve (in writing) a determination of a penalty under sections 6651, 6654, and 6665, or any other penalty automatically calculated through electronic means.

The penalties that you referenced in your request for advice (section 6721 and section 6722 penalties and other compliance penalties such as for dyed diesel fuel) are not penalties that are automatically calculated through electronic means. These are penalties that an agent must review for compliance before determining if the penalty is applicable. They are subject to the requirement of supervisory approval prior to assessment.

If you have any questions or concerns regarding this response, please contact Brad Taylor at (202) 622-4940.

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By:

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